

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. (This is a PLR.)

April 9, 2002

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see www.revenue.state.il.us/Laws/regs/part1200/), is in response to your letter of January 18, 2002. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to AAA for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither AAA nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

This letter is being sent to request a private letter ruling regarding the taxability for Illinois Retailers' Occupation Tax purposes of the software license fees received from the Illinois customers of AAA and related subsidiaries BBB and CCC Hereinafter the group will be referred to as AAA Retailers' Occupation Tax on software license fees received from Illinois customers is currently collected by AAA and remitted to the State of Illinois. Illinois Department of Revenue Regulations, Title 86 Part 130 Section 1935 states that a license of computer software is not a taxable retail sale if five specific criteria are met. A copy of this regulation is enclosed for your convenience. Specific discussion of each of the five criteria delineated by the regulation follows below. The information required by Illinois Department of Revenue Regulations, Title 2 Part 1200 Section 110 relating to Private Letter Rulings have been incorporated into the following ruling request. A copy of this regulation is also enclosed for your convenience.

In addition to the items mentioned above, copies of the basic license agreements for each of the AAA core software applications are included. A copy of the basic license agreement for ancillary software applications for customers that do not have a core product license in force is also provided. Sample BBB and CCC license agreements are also provided. The enclosed license agreements are representative in all applicable respects of the license agreements in force between AAA and our Illinois customers.

Paragraph a)1)A) of Section 130.1935 of Title 86 of the Illinois Department of Revenue Regulations requires that an exempt software license be evidenced by a written

agreement signed by the licensor and the customer. The copies of license agreements provided as listed above satisfy this requirement.

Paragraph a)1)B) requires the license to restrict the customer's duplication and use of the software. Within the agreement, paragraph 7 prohibits 'unauthorized...duplication of any of the software.' Likewise, paragraph 7 of the SYSTEM agreement and paragraph 11 of the ancillary software agreement prohibit unauthorized duplication of the software. Paragraph 3 of both the agreement and the SYSTEM agreement as well as paragraph 2 of the ancillary software agreement and section 8, paragraph b of the BBB agreement and section 2, paragraphs a) and b) of the CCC agreement restrict the licensee's use of the software to specified equipment and for specific purposes.

The requirement of paragraph a)1)C) of section 130.1935 is to 'prohibit the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor.' This requirement is addressed in paragraphs 3, 5, 7 and 16 of the agreement. The SYSTEM agreement, in paragraphs 3, 5, 7 and 17, similarly deals with this requirement. Within the ancillary software agreement, paragraphs 4, 9 and 19 address the section 130.1935 paragraph a)1)C) licensing, sublicensing and transferring prohibitions while section 8, paragraph b of the BBB agreement and section 2 paragraph a) of the CCC agreement address these constraints.

Section 130.1935 paragraph a)1)D) requires the licensor to provide copies at minimal or no charge in the case of loss or damage to the software. The licensor also has the option of allowing the licensee to make and keep an archival copy to satisfy this requirement. While the enclosed license agreements do not specifically address this constraint, paragraph a)1)D) does contain a provision allowing the use of a notarized statement to address this issue. A notarized statement confirming AAA's policy of permitting licensees to make archival copies of the licensed software for protection against lost or damaged software is enclosed.

The final paragraph of section 130.1935 pertaining to this issue is paragraph a)1)E). This paragraph requires the licensee to 'destroy or return all copies of the software to the licensor at the end of the license period.' This requirement is addressed in paragraphs 3 and 9 of both the agreement and the SYSTEM agreement. The ancillary software agreement deals with this condition in paragraph 13. The BBB agreement satisfies this requirement with the language in section 8, paragraph c. Finally, compliance with regulation section 130.1935 a)1)E) is outlined in section 10, paragraph b) of the CCC agreement.

There is currently an Illinois Retailers' Occupation Tax audit pending with the Illinois Department of Revenue for tax periods July 1998 through December 2000. Neither AAA nor the Illinois Department of Revenue is contesting any issue addressed in this letter ruling for the periods under audit. AAA will institute any changes arising from a positive response from your office beginning with the first tax period after receipt of a favorable letter ruling.

To the best of my knowledge, the Illinois Department of Revenue has not previously ruled on the same or a similar issue for AAA, any related subsidiary or any predecessor. Additionally, neither AAA nor any duly appointed representatives have previously

submitted the same or a similar issue to the Illinois Department of Revenue and withdrew it before a letter ruling was issued.

A review of the Illinois Department of Revenue authorities relating to the taxability of software license fees for the purposes of the Illinois Retailers' Occupation Tax failed to turn up any authorities contrary to our view that AAA's software licenses comply with regulation section 130.1935 a)1)A) through E) making them nontaxable retail sales.

AAA requests that all attachments submitted with this private letter ruling request be deleted from any publicly disseminated version of this ruling in the interest of preserving trade secret information. In addition, please remove all references to specific software titles from any and all publicly distributed versions of this ruling.

Please direct any questions or requests for additional information, as well as your response to our private letter ruling request, to:

NAME/ADDRESS

Thank you for your attention to this matter.

86 Ill. Adm. Code 130.1935, Computer Software, has been recently amended. See enclosed revised copy of Section 130.1935. Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

The agreements attached to your letter, specifically the license agreement, the SYSTEM license agreement, the Ancillary Software Application license agreement, the BBB license agreement, and the CCC license agreement, meet the criteria set forth in Section 130.1935. Therefore, the agreements qualify as licensing agreements that are not subject to tax.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.